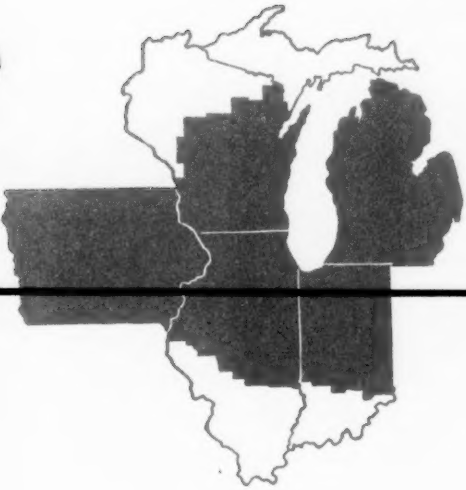
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1957 September

Contents

THE Trend OF BUSINESS

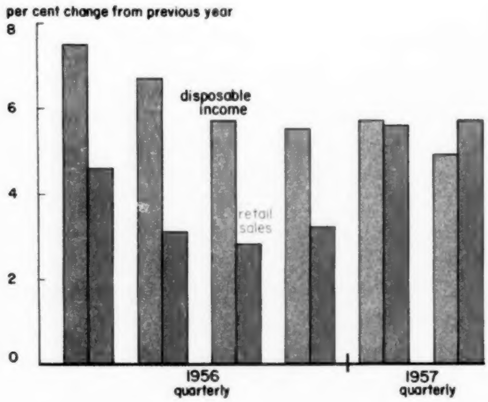
The most noteworthy economic development of recent months now appears to be the evidence that consumer buying at retail stores has again turned upward.

From November of 1956 through last April, retail sales, seasonally adjusted, charted a horizontal line. Recent data show that this plateau was broken in May, and that in subsequent months higher totals have been rung up on merchants' cash registers. Reports on improved retail sales have been accompanied by slight but significant upward revisions of the estimated level of industrial production and employment for late spring and early summer. But these developments have not been as pronounced as the uptrend in consumer buying.

In the six months ending in April, retail sales had varied only slightly from the 16.3 billion dollar monthly level. In May this figure jumped to 16.6 billion. June saw another advance to 16.8 billion and the preliminary report indicates another record for July at 16.9 billion.

Translated into annual rates, the indicated rise in retail sales between April and July amounts to over 7 billion dollars. This increase dwarfs the recently announced adjustments in military outlays. The stretch-outs and abandonments of military aircraft and missile procurement programs, moth-balling of warships, reduction in progress payments, and slashes in man power are expected to reduce defense spending by about 2 billion dollars, to a level 5 per cent below the current rate.

In 1957 retail sales gains have matched increases in consumer buying power



A secondary effect of any sustained upturn in consumer takings could be a more confident attitude on the part of businessmen toward pending decisions on inventory policy and capital outlays.

A stronger picture than in 1956

Recent evidence on retail buying is particularly encouraging when compared with results recorded in 1956. In the first quarter of last year retail sales declined moderately from the rate of the final months of 1955. The pickup in the late spring of 1956, there-

fore, represented a recovery from a somewhat depressed level. In 1957, there has been no quarter-to-quarter decline. First-quarter sales showed a margin of close to 6 per cent over a year ago. In the April-June quarter a similar gain over last year occurred and it appears that this relationship continued into midsummer.

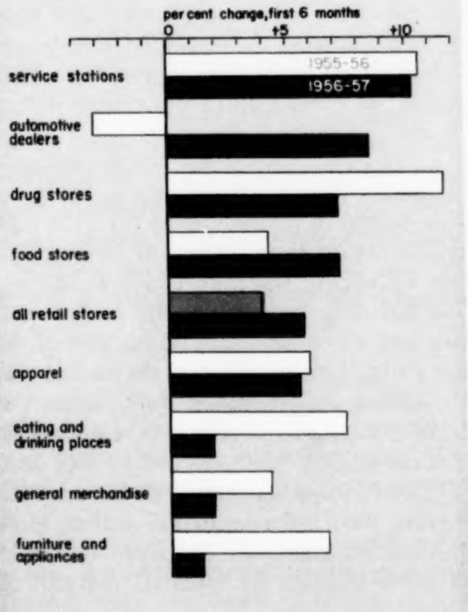
It is noteworthy, also, that all major retailing groups have been participating in the improvement during 1957. The difference between experience in the two years is largely accounted for by the sales of automotive dealers which had weakened in the spring of 1956 but showed substantial gains this year.

Department store sales climbed to a new seasonally adjusted high of 133 per cent of the 1947-49 average in July, 5 per cent above June. Midwest department store experience has been in line with the national record as shown in the following table:

	Change from year ago	
	Four weeks ending Aug. 17	Thirty-three weeks
United States	+3	+2
Chicago	+5	+4
Detroit	+2	+3
Indianapolis	+1	+1
Milwaukee	+3	+2
Other Cities	0	+2

Another contrast with 1956 is found in the relationship of retail sales to disposable income — the money left to individuals after providing for taxes. In the first half of 1956, retail sales exceeded the comparable year-ago figure by 4 per cent. This was a good showing, but substantially less than the 7 per cent increase in disposable income. So far in the current year, the 6 per cent rise in retail sales has matched or slightly exceeded the advance in spending power.

Sales of all major retail groups are higher than in 1956



Manufacturing still lags

Unlike the nation's retailers, the "producer" segment of the economy had not enjoyed an increase in sales in the late spring. Manufacturers' sales hit a high of 29.2 billion dollars, seasonally adjusted, last January and by June had declined 3 per cent to 28.4 billion. Manufacturers' sales usually run about double the retail total, because of final sales to governmental bodies and other businesses as well as sales of raw materials and semi-finished goods to other firms for further processing.

In large part the slackness in manufacturing production and sales can be traced to the desire of many business managers to keep inventories at minimum levels. An analysis of the trends in the components of the Fed-

eral Reserve index of industrial production clearly indicates that, for the most part, those lines which supply materials to other industries for additional processing have been cut back the most.

Over-all, June industrial production was 2 per cent below December's record. Within this total, primary iron and steel and nonferrous metals declined 8 per cent from December to June, while output of fabricated metal products was somewhat higher. Textile mills were operating at 3 per cent below their December level while apparel factories were reporting production up 3 per cent. Paper mills, also, were producing below the highs of last year, while printing and publishing was at a record level.

The inventory policies of business firms continue to provide a focal point of interest. Book value of producers' stocks virtually ceased to rise in June despite continued price increases. Retailers increased their holdings in May and June, but not as fast as the rise in their sales.

Money demands remain strong

Despite a leveling tendency in business investment in plant and equipment and inventories and continued slack in home building so far in 1957, aggregate credit demands continue to be very great.

August was studded with sharp reminders of the pressure upon the available supply of loanable funds. The maximum rate on FHA loans was raised from 5 to 5¼ per cent (5¾ to the borrower who must contribute an additional ½ per cent to the insurance fund). The posted rate charged prime borrowers by large banks was raised ½ per cent, to 4½ per cent, and upward adjustments were made on commercial paper and bankers' acceptances. In late July the Treasury had made a large offering of short-term securities at 4 per cent.

The huge volume of funds required by corporations has played a major role in the upsurge in interest rates. In the first half of 1957, 6.5 billion dollars of stocks and bonds were sold for new capital — one-third more than the record 1956 total. July and August also exceeded last year, although by a smaller proportion. Moreover, calendars of scheduled offerings are reported to be heavy through October.

Inducements offered to bond buyers have included yields as high as 5.2 per cent on high-grade issues, "no call" features and other provisions tailored to attract investor interest. Sales finance companies have been in the forefront of the recent list of corporate flotations. Several of the larger firms have sold issues ranging up to 100 million dollars in size.

Pay-backs of bank loans with the proceeds of security issues was a primary factor in the July decline in business loans from the high established after the June tax borrowings. For all weekly reporting banks in the nation this drop was almost 800 million dollars, and wiped out about 60 per cent of the rise during June. In Chicago the decline was 90 million dollars during July, about the same as for the entire District. In other District cities no decline occurred in July and, of course, some individual banks were increasing their loans during this period. Most Midwest bankers have continued to report an active demand for loans on the part of business borrowers.

Few jobless in most areas

Employment in the nation's nonfarm establishments set a new high for July. Moreover, unemployment was calculated to be only 3 million, slightly less than last year.

The 52.8 million working at nonfarm jobs, seasonally adjusted, was 1.3 million more than last year. If an adjustment is made for last year's steel strike the year-to-year gain in employment is about 800,000. This compares with an average annual growth of 940,000 over the past ten years.

		July 1956		July 1957	
Group	Per cent unemployed	U.S.	Seventh District	U.S.	Seventh District
A	less than 1.5	0	0	2	0
B	1.5 - 2.9	52	12	41	10
C	3.0 - 5.9	74	5	82	7
D	6.0 - 8.9	15	5	16	6
E	9.0 - 11.9	5	2	7	1
F	12.0 and over	3	0	1	0

The number of persons receiving unemployment compensation has remained low. Except for Michigan, unemployment in the states in this area compares favorably with the nation. Even in Michigan, however, estimated unemployment has been somewhat less than in 1956.

Every two months the Bureau of Employment Security surveys 149 of the nation's major job markets and classifies them according to the current and prospective unemployment situation. As of July the job market in the Midwest was fairly strong except for Michigan. In the most recent classification Terre Haute, Indiana, was moved up a notch while Detroit and Flint were downgraded.

Among the Midwest cities in the "B" group at the present time are Chicago, Aurora, Joliet, Peoria, Rockford, Indianapolis, Madison, Milwaukee, Cedar Rapids and Des Moines. In "C" are the Quad Cities, Fort Wayne, South Bend, Racine, Kalamazoo, Battle Creek and Lansing. "D" cities include Terre Haute, Kenosha, Detroit, Grand Rapids and Muskegon. Only Flint is in the "substantial unemployment" "E" category.

Thus, at the present time, Midwest unemployment is tied closely to the auto industry. Work on new models which is now under way is expected to alleviate this situation to some extent in the fall.

Construction still a prop

Although home-building activity remains at a reduced level, the over-all construction picture allows little cause for pessimism. For the first half of 1957, the value of construction put in place was 3 per cent more than last year.

At least part of this rise represented higher prices. But in midsummer construction contractors were employing slightly more persons than last year, suggesting a high level of physical activity.

Expenditures on new dwelling units were

off 12 per cent during the first half, and commercial building and farm construction also were lower than last year. But public outlays were 11 per cent higher than 1956 and industrial, public utility, and various other types of nonresidential construction also rose substantially.

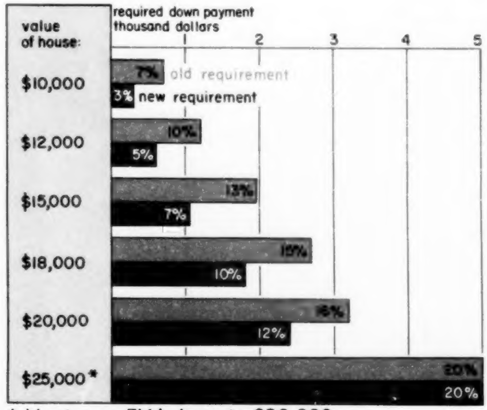
More pertinent to second-half construction prospects, recent figures on contract awards reported by F. W. Dodge have indicated continued strength. In June, total awards were 10 per cent above 1956 compared with a gain of 5 per cent for the year to date. The major categories are shown in the following table. Increasingly the construction boom is being carried forward by the public works and public utilities sectors.

	Per cent change, second quarter 1957 from second quarter 1956	
	U.S.	Seventh District
Total	+ 5	+ 6
Residential	— 4	— 17
Nonresidential	+ 2	0
Public works & utilities	+27	+109

It is widely recognized that the brunt of the decline in housing outlays has involved units financed by insured or guaranteed mortgages. At the maximum authorized rate of 4½ per cent, VA-financed home building has been cut back sharply as other interest rates have advanced. In July, for example, VA appraisal requests were down 60 per cent from the same month in 1956. FHA rates had been raised to 5 per cent last December, with little noticeable effect on the market.

It is believed, however, that the early August advance in FHA rates to 5¼ per cent and the accompanying reduction in down payments will increase to some extent the flow of institutional funds to this type of investment. Should the flurry of corporate offerings taper off toward year end, it is

FHA down payments substantially reduced for low- and medium-priced homes



* Maximum FHA loan is $20,000.

possible that a significant shift in the investment policies of insurance companies and other lenders toward residential mortgages could occur in 1958.

Any stimulus to home building will be welcomed by builders and building tradesmen who have not been able to shift into nonresidential lines. In the first half of 1957, housing starts nationally were off 16 per cent from the previous year, which in turn had declined sharply from 1955. In the Midwest, Chicago, Detroit, Indianapolis and Des Moines have reported declines ranging from 19 to 29 per cent. Only Milwaukee among the larger District cities has shown up better than the nation.

Based on previous experience with lowered minimum down payments, the recent cuts should attract additional buyers to the market, providing of course that lenders "go along" with the new terms. Some insurance companies have indicated a willingness to accept the lower down payments, although this does not necessarily mean that additional

funds are being allocated to mortgages. That decision is based upon a comparison of yields on alternative investments.

Very little new housing is being placed on the market in the Midwest in the $10-12,000 bracket which is fairly common in the South and West where costs are lower and standards are less exacting. The bulk of Midwest builders operate in the $15-20,000 market. For these homes, down payments have been lowered by 30 to 50 per cent.

It is possible that these changes will further accelerate the reported tendency for area builders to aim at lower selling prices for their new homes. The down-payment reductions are of little or no consequence over the $20,000 valuation since the maximum FHA loan is only $20,000. Moreover, the greatest easing in down payments under the new terms is around $15,000. As a result, further attempts to cut offering prices by eliminating appliances, reducing home size or effecting other economies can be expected.

Some lenders point out that, increasingly, inadequate income rather than the lack of cash for down payments may become the principal obstacle facing prospective home buyers. Advances in the cost of land and buildings, increases in interest rates, property taxes, insurance, and other carrying charges are making it more difficult for home buyers to meet lenders' rules of thumb. A typical requirement is that the sum of all carrying charges should not exceed 20 per cent of gross income. On a 5¾ per cent 25-year loan, the maximum term offered in this area, the indicated annual income needed to carry a $16,000 mortgage is about $7,500, a figure well in excess of the average. Some alleviation of this situation could result from a stretch-out of the term to 30 years. A 30-year loan at 5¾ per cent has the same amortization charge as a 5 per cent loan at 25 years.

Something new in farm land values?

Farm real estate prices continue upward. Early this year Government estimates indicated the average U.S. value per acre was about double the 1945 figure. A July survey of Midwest country bankers shows a further rise since last spring.

But interest is focused currently, not so much on the over-all postwar rise as on the upsurge since 1954. In this period there has been continued and heavy dependence on Government programs to support farm income, and there has been little net change over-all in the levels of realized net farm income or farm commodity prices, although both have been tilted slightly upward in 1956 and 1957. Notwithstanding the basically weak situation in agriculture, a vigorous and persistent rise in price of farm real estate has taken place in each of the last three years, and the advance continues.

In perspective

Historically, the price of farm land has generally followed changes in prices of farm commodities and farm income, with a lag of about 1 to 2 years. The reason for the lag, in the words of USDA experts, writing in 1949, is:

> . . . the uncertainty that a particular level of income will be maintained long enough to warrant a change in land values. Higher farm earnings for a single year, or even for several years are largely discounted unless it appears relatively certain that they will continue for a considerable period. Even then, the full increase in income is seldom capitalized into land values.

Around World War I, 1912 to 1920, for example, land values increased about 1 per cent for each 2 per cent increase in realized net farm income. Around World War II, 1939 to 1947, the increases in both land values and net farm income were much greater, but the relative gains did not differ greatly from those in the World War I period. For each 1 per cent increase in land values, farm income rose about 2.2 per cent. Apparently the buyers of farm land were inclined to regard the war-induced income gains as temporary, at least in part, and rightly so.

	Per cent change in:	
	Realized net farm income	Value of farm real estate
Going up —		
World War I period —		
1912-14 to 1920. .	+144	+ 72
World War II period —		
1935-39 to 1947. .	+266	+119[1]
Going down —		
World War I period —		
1919 - 1921	− 59	− 18
1919 - 1929	− 34	− 33
World War II period —		
1947 - 1955	− 34	+ 27[2]
1947 - 1957	− 28	+ 40[2]

[1] Includes land value rise to 1949.
[2] Includes change in land values from 1949 peak.

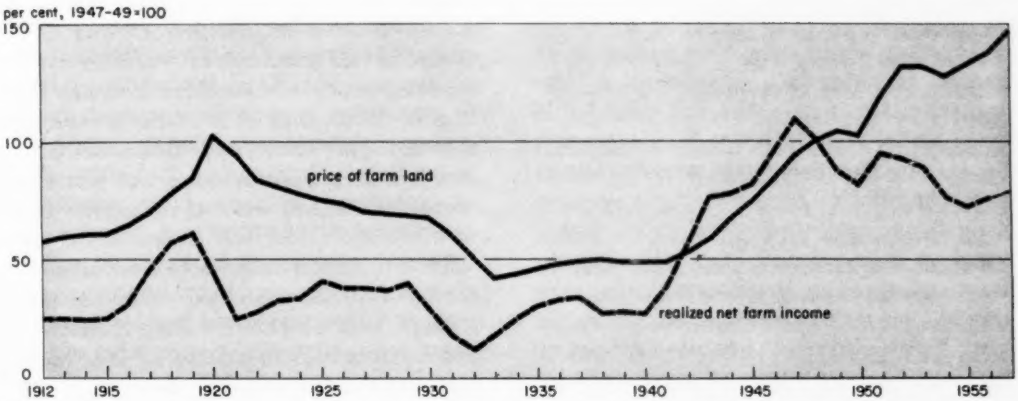
Farm income declined following both World Wars. In 1921 net farm income had fallen nearly 60 per cent from its 1919 peak and was about at its prewar level. The 1947 peak in net farm income, on the other hand, was followed by a slower and irregular decline. In 1955, realized net farm income, at its lowest level since 1947, was about one-third below its postwar peak, but was still more than one and one-half times above its prewar level.

Similarly, prices of farm real estate have followed quite different courses in the two postwar periods. Land values followed a downward trend between 1920 and 1929, even though farm income recovered somewhat following 1921 and was quite stable from 1925 to 1929. Thus, in that period land values and farm income followed different trends, due in part to a burdensome farm debt situation which weighed heavily on land values throughout the Twenties and at least the first half of the Thirties.

Since 1947 farm income and land values over-all have again followed different trends. However, there were indications in 1949-50, prior to the outbreak of hostilities in Korea, that the price of farm real estate was responding to the effects of declining prices of agricultural commodities and reduced farm income. Again in 1952-53, as Korea cooled off and agricultural prices and farm income slumped, land values softened somewhat. These leveling tendencies were generally interpreted to indicate that purchasers, and owners, of farm real estate believed the then prevailing land prices were as high as were justified by current and prospective farm income.

Such is the backdrop against which an "amazing upsurge" in price of farm land has taken place since 1954. The gain of 7 per cent in the twelve months ending in March

Farm land prices usually follow changes in farm income



1957, according to the USDA, "was the largest since the post-Korean peak was reached in 1951-52." Furthermore, this rise has taken place in the face of persisting problems of surplus supplies of agricultural commodities.

Price-income ratios

It is common knowledge that "expectations" have an important effect on the value investors place on a resource possessing a long, useful life at any particular time. Depending upon their "view of the future," prices of land, common stocks and other equities may be bid to high or low levels in relation to the current income realized from them.

One measure which reflects changes in expectations is the ratio of current prices to earnings. This ratio is widely used with respect to common stocks, but is not so readily applicable to farm real estate since the current earnings attributable to land are difficult to measure. However, an approximation is provided in the ratio of land prices to realized net income of farm operators from farming.

The estimated total value of U. S. farm real estate in March 1957 was 109.5 billion dollars. Realized net farm income in the two preceding years, 1955 and 1956, averaged 11.5 billion. Thus, farm land was valued at an amount equal to about 9.5-years realized net farm income. This ratio has been creeping up in recent years, after reaching a very low figure at the close of the war in 1945, and in 1956 was the same as in the mid-Twenties.

1915	12.7	1940	8.4
1920	8.5	1945	5.0
1925	9.5	1950	6.7
1930	8.4	1955	8.8
1935	8.4	1956	9.5

The postwar "softenings" in land values in 1949-50 and 1952-53 took place at a ratio of about 6.7.

The ratio of land values to farm income appears to provide no sure guide to the probable trend in land prices. About all that can be concluded from a review of ratios in past years is that the ratio in 1954, from which the recent upsurge in land prices took off,

appears in terms of historical perspective to have been relatively low.

The "lower ratio" idea

However, there have been a number of reasons advanced in justification of a "permanently" lower ratio than had prevailed in some earlier periods. It has been suggested, for example, that rising wage rates and attractive opportunities for off-the-farm employment should cause farmers to place a higher value on their personal labor and management and, therefore, attribute a smaller portion of their realized net farm income to the land. This would tend to reduce the level of land values which would be "supported" by any given level of farm income. Similarly, rising interest rates and the large increase in amount of non-real estate capital required in modern agriculture would tend to restrain advances in land values.

Possibly most important have been the rapid gains in technology, which have boosted output per acre and had an effect much the same as an increase in the supply of agricultural land. One result of this advancing technology has been to perpetuate a condition of "excess" capacity in agriculture and the related problems of surplus supplies and downward pressures on farm income. And there is little evidence that the problem is becoming less severe.

Factors back of the price rise

Many factors have been cited as possible explanations for the recent surge in farm land values, including: general economic recovery from the mild 1953-54 recession, renewed inflationary pressures, continued growth of population, diversion of farm land to nonagricultural uses, pressures to enlarge farms, new and expanded Government programs to assist farmers, and increases in maximum amount lenders would loan per acre. However, several of these factors are not new to the farm scene.

Population. The U.S. and world populations, for example, have shown growth trends of long standing. True, expectations relative to population growth were revised sharply during and immediately following World War II, and these, presumably, had some effect on expectations relative to future demand for agricultural commodities and, therefore, on farm real estate prices. However, no striking changes have occurred in the population outlook of a type that could provide a springboard for a substantial rise in value of farm land in the last few years.

Nonagricultural uses. Agricultural land has been subdivided for residential and commercial uses and converted to public uses, including roads, schools and recreational areas at an estimated rate of about one million acres a year. This is equivalent to less than one-fourth of 1 per cent of the total supply of cropland and may be compared with the current efforts to achieve about a 30 million acre reduction in planted crops under the soil bank program. There is no indication, therefore, that these nonagricultural requirements for land provide an important drain on the amount of land available for agriculture.

Nevertheless, the conversion of farm land to nonagricultural uses does appear to have played an important role in the upsurge in land values in some areas, even though the effects over-all probably are not greatly different since 1954 than in prior years. The effects have been largely of two types: (1) sales for nonagricultural uses typically are at substantial premiums above the current value for strictly agricultural uses, and these prices tend to establish "reservation prices" below which land over a large adjacent area

is not offered for sale; (2) farmers who sell land for nonagricultural uses usually seek to reinvest in farm land and, in a period when a relatively small number of farms is offered for sale, this provides a strong upward pressure on prices in the affected areas. In some areas other factors such as discovery of oil, actual or expected provision of water for irrigation, and relocation or basic improvement of highways have boosted "reservation" prices and restricted offerings.

Bigger farms. In a recent survey of Midwestern country bankers, one-third of the respondents reported that in their opinion the demand for land to enlarge existing farms was "the principal factor" causing the rise in farm land prices. Other surveys have indicated that a large proportion of the sales of farm land, running in excess of 50 per cent in some areas, have been to farmers who were enlarging their current operations. And along with the economic pressures to enlarge farms, there has been present in rural areas, to a degree not known in the Twenties and Thirties, the financial ability to acquire additional land.

	Farmers' holdings of bank deposits, currency and U.S. savings bonds	Farm debt, excluding "merchant credit" and loans guaranteed by CCC
	(billion dollars)	
1920	N.A.	11.9
1925	N.A.	12.7
1930	N.A.	11.1
1935	N.A.	8.6
1940	3.4	8.1
1945	11.3	6.5
1950	13.9	8.4
1954	14.6	11.6
1955	14.8	12.3
1956	15.1	13.5
1957	15.2	14.4

N.A. Not available.

Despite the uptrend in farm debt since 1945, proprietors' equities in agricultural assets have increased sharply. While the rise has been due largely to the higher prices of farm real estate, it reflects also materially larger amounts of non-real estate assets. Estimated at about 84.8 billion dollars in 1945, proprietors' equities had risen to 157 billion at the beginning of 1957.

But why should the pressure to enlarge farms have become an especially important factor in the market since 1954? Farmers have felt a need for larger farms ever since men first started adapting machines to agricultural applications, and farmers, over-all, have been well able to finance additional purchases of farm real estate throughout most of the Forties and in the Fifties, both prior to and following 1954, if they desired to do so. Neither the impact of mechanization nor changes in the financial position of farmers appears to provide an adequate explanation for the upsurge in land values in recent years.

A new psychology?

What is required to explain the post-1954 advance in land values are developments which account for a retrenchment in offerings of land for sale concurrent with an increase in demand. The number of farm transfers dropped to a very low level in 1954 — 44 per 1,000 farms — and, although rising slowly in 1955 and 1956, has remained relatively low.

Several factors are "new" to the scene and must be presumed to hold the key to a shift in expectations on the part of both owners and prospective purchasers of farm real estate which, in turn, has provided the basis for the recent advance in the ratio of land values to farm income.

1. *The Federal Old Age and Survivors Insurance program* (social security) was amended in 1954 to extend coverage to farm operators. The terms were very attractive to farmers approaching retirement age and, no

doubt, caused many farm owners who normally would have disposed of land in recent years to defer its sale so as to qualify for social security benefits. Also, it is possible that the program increased the demand for land as individuals who had "retired" previously again sought to become "active" operators for the purpose of qualifying for social security benefits. Furthermore, the program probably encourages the retention of land capable of yielding a reasonable rental income after retirement age since rent, along with some other forms of income, is excluded from the 100 dollars a month earnings permitted after retirement without an offsetting reduction in social security benefits.

2. *The Agricultural Trade Development and Assistance Act of 1954* authorized among other things a large program of foreign disposal of agricultural surpluses, including sale for foreign currencies. In agricultural circles there had been a growing concern that the postwar price support program was rapidly becoming bogged down in a sea of surpluses. At the same time, there was a widely held view that an almost unlimited "demand" for agricultural products existed in many low-income countries, but that this demand was ineffective in world markets due to a lack of dollar exchange. No doubt many farmers saw in this program, and in the large expenditures authorized to implement it,[1] a means of disposing of agricultural surpluses and an indication that the Congress was willing to extend assistance to agriculture on a scale not experienced heretofore.

3. *A soil bank program* was authorized in the Agricultural Act of 1956, signed by the President in May of that year, providing further evidence that the Congress was prepared to provide large additional assistance to agriculture. Payments to farmers and others owning or leasing farm land were authorized in an amount of 1.2 billion dollars a year under the soil bank program. Although the major portion of the program was authorized for only a four-year period, many farmers have assumed that it is likely to be continued indefinitely.

Programs which support prices of agricultural commodities and farm income are generally believed to affect prices of farm real estate. In some areas the effects are closely related to acreage allotments of specific crops and therefore are quite obvious, but the impact usually is far from clear cut.

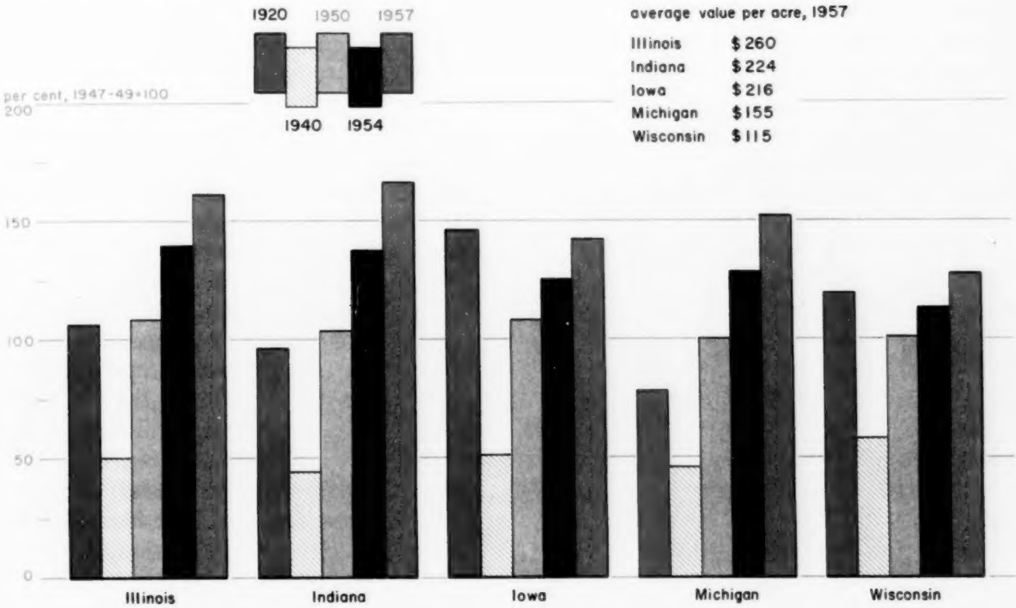
A USDA survey made in early 1957 indicated that the soil bank program was serving to "support or raise market prices for land." The effects were most evident in the major spring wheat and winter wheat areas where participation in the soil bank program was most widespread. Survey respondents noted that the program had caused both some increase in inquiries as to land for sale and some withdrawal from the market of land which had previously been offered for sale. It may be significant that the rate of rise in land values accelerated in the year following enactment of the soil bank program.

4. *The downtrend in realized net farm income* was halted about the end of 1955, due largely to the effects of the "new" and enlarged Government programs and the vigorous expansion of business both at home and abroad. Many farmers apparently believed that "the worst had passed" and that the modest recovery in 1956 was a return to a postwar "normal," the persistence of surpluses notwithstanding.

Also, country bankers have reported that farmers who had been waiting for favorable

[1] The initial authorization of 700 million dollars was raised to 1.5 billion in July 1955, and subsequently to a total of 4 billion.

Land value changes in District states



opportunities to buy additional land apparently decided that further waiting would be in vain and proceeded to activate their long-term plans. It should be noted in this respect that many farm families invest primarily, or exclusively, in real estate. The erosion of "pessimism" in rural areas, as indicated by the re-evaluation of farm real estate, lagged the build-up of "optimism" in urban centers, as indicated by the trend of stock prices, by about a year.

5. *Inflation* has been publicized widely since mid-1955 when the current business boom first started generating important upward pressures on prices. Many families, both farm and nonfarm, believe investment in farm real estate provides a good inflation hedge. Whether or not it would in fact provide a good hedge is beside the point as prices reflect opinions and expectations to the extent that these are translated into current supply-demand forces in the market through the actions of buyers and sellers. In a recent Midwest survey, 27 per cent of the reporting country bankers indicated that "inflation-hedge" buying has been one of the principal factors affecting the demand for farm land.

Buying by nonfarmers is an important factor in the market. In most years since 1951, nonfarmer buyers accounted for about one-third of the number of purchases. The proportion appears to have increased somewhat in the spring of 1956, but dealers estimated that inquiries from nonfarmers in the summer and fall for land declined relative to inquiries from farmers. Thus, while "inflation-hedge" buying appears to have been a significant factor in the recent advance in farm real

estate prices, there has been no strong or obvious move on the part of nonfarmers to transfer large amounts of capital to rural real estate. Instead, the effect seems to have been to cause those who own land to defer sales, and to cause those who have had plans to .cquire land to attempt to carry out their plans rather than defer longer in the hope of obtaining a more favorable purchase.

Something new?

The *new* element in the farm real estate market is the *shift in expectations* — from the "bearish" views, which predominated in 1949-50 and again in 1952-53, to a "bullish" view, which has demonstrated increasing muscle since 1954. The bearish views had brought the postwar advance in price of farm real estate to temporary halts at levels which, judged by some historical standards, were relatively low. However, the then existing agricultural situations, and the long-term prospects for the trend of net farm income appeared to justify relatively conservative prices for farm land.

The resurgence of the postwar advance in price of farm real estate since 1954 reflects the net confluence of many forces. Among these was a spilling over into the agricultural sector of some of the exuberance spawned by the vigorous expansion in the nonagricultural sector, along with its accompanying inflationary pressures. But Government actions appear to have been a major factor.

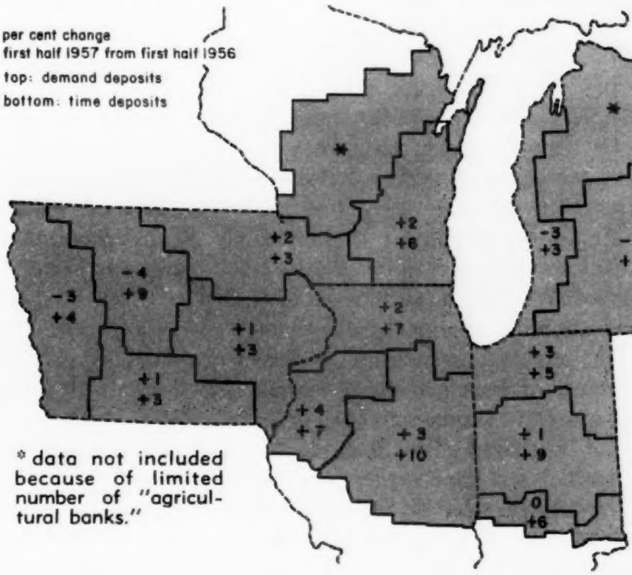
A lift of some importance, although probably a temporary one, flowed from the extension of coverage of the social security program to farmers. But the most significant factor seems to have been the "new" and greatly expanded programs to dispose of surpluses, curb output and raise farm income. These actions succeeded in halting the downward trend of farm income in 1955 and are largely responsible for the modest gains in 1956 and 1957. They are interpreted by some farmers as providing a framework within which the cost-reducing benefits of improved technology can be reaped in future years while avoiding the full impact of the increased output on prices of agricultural commodities and farm income. One consequence has been that owners of farm real estate have become more desirous of retaining their holdings while prospective purchasers have become more aggressive. The result: a "thin" market tilted sharply upward as the new pattern of expectations is capitalized into higher current prices.

Deposits rise at "farm" banks

Recent gains in farm income have increased the spending capacity of the rural sector. And reports of sales of certain kinds of products indicate farmers are expanding their purchases. Most of these indicators, however, pertain to states or larger regions. Individual areas often do not follow national trends.

It is evident, of course, that changes in deposits and loans of commercial banks reflect the business activity of the communities they serve. This is true especially for the

Time deposits in "agricultural banks" have increased in all areas and show larger percentage gains than demand deposits



smaller banks and those located in small centers. Most farmers' accounts, for example, are in banks located in predominantly agricultural areas, typically in the smaller cities and towns. It is possible, therefore, to make some inferences relative to changes in financial developments in farm areas by analyzing deposit and loan trends of selected groups of rural banks.

From the 1,025 member banks in the Seventh Federal Reserve District, 355 have been identified as predominantly "agricultural banks." The 355 included in this group are mostly located in counties in which the primary source of income is from farming, and 35 per cent or more of their total loans are farm loans.

Deposits in these agricultural banks during the first half of 1957 were above year-earlier levels in most District areas. Demand deposits averaged slightly more than in the first six months of 1956, and time accounts showed a 5 per cent gain. The increases largely reflect improvement in farm income that has taken place since the winter of 1955-56. Through May of this year, cash receipts to District farmers from crop and livestock marketings totaled 6 per cent more than in the corresponding five-month period of 1956.

Area differences

However, increases in deposits of agricultural banks have not occurred in all District areas (see map). In western Iowa drouth in 1955 and again in 1956 cut crop output, curtailed livestock production and reduced farm income. In this area demand deposits of agricultural banks in the first half of 1957 averaged 4 per cent below the year-ago level. Other important agricultural areas to show lower demand deposits than in early 1956 were the fruit area of western Michigan and the general farming area of southeastern Michigan. However, in Michigan areas higher savings balances more than offset the decline in demand accounts.

In all other District areas, except southern Indiana, demand deposits at agricultural banks have increased. The largest gains were in central Illinois where 1956 proved to be a banner crop year.

Time deposits in agricultural banks increased throughout the District during the past year and generally at a faster rate than checking accounts. Gains ranged from 3 per cent in eastern Iowa and western Michigan to 10 per cent in east central Illinois. No doubt, a part of the increase reflects the higher rates of interest on savings accounts instituted by many banks in the past year or so. To what extent, if any, it reflects a more conservative spending attitude on the part of farmers is difficult to determine.

While early in the year many Midwest farmers reduced their spending for farm machinery and consumer durable goods such as autos, TV sets and appliances, by late spring a number of farm machinery manufacturers reported that farmer buying of their products had improved. Fertilizer manufacturers reported a similar experience, although the increased sales of this product appeared to be more in response to drouth-breaking rains than to improved income. And country bankers have reported that some farmers are utilizing their larger incomes to replenish cash balances and to reduce debts accumulated in recent years. "Short-term" farm loans outstanding at Midwest banks in early summer showed only modest gains from a year earlier in most District farming areas, and most of these increases seemed to be associated with higher cash operating expenses and to a larger number of cattle on feed.

Further deposit gains?

Prospects for continued favorable livestock prices during at least the remainder of the year suggest further deposit gains in areas specializing in the production of these commodities. Both hogs and cattle have shown considerable price strength in 1957. Hog prices in the first seven months of the year averaged 28 per cent above the corresponding period of last year; the gain for cattle was 13 per cent. Milk, on the other hand, showed only a small rise — 3 per cent — and prices of eggs and chickens averaged 21 and 10 per cent respectively below their year-ago levels.

Trends in cash crop areas will reflect primarily the output and prices of corn, soybeans and wheat. As of mid-August, prospects were very favorable for all Iowa areas, but less favorable than a year ago in the cash grain areas of Illinois and Indiana.

	Indicated production, 1957, per cent change from 1956			
	Corn	Soybeans	Wheat	Oats
Illinois	−28	−20	−41	−26
Indiana	−24	− 6	−12	−32
Iowa	+11	+28	+53	+63
Michigan	−12	+20	−10	+18
Wisconsin	−13	+26	+ 5	+ 4

The price of corn is materially below year ago, reflecting the large total supply of feed grains available, while prices of other major District crops show only small changes.

	Recent price, Chicago (per bushel)	Per cent change from year ago
Corn	$1.32	−17
Oats	.75	+ 1
Soybeans	2.42	0
Wheat	2.20	+ 1

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